

AR23

1977
*Annual
Report*



Pile
Lochiel Exploration Ltd.

Contents

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1977 HIGHLIGHTS

| | <u>1977</u> | <u>1976</u> |
|-----------------------------------|-------------|-------------|
| Gross revenue | \$1,796,000 | \$1,806,000 |
| Cash flow from operations | 812,000 | 930,000 |
| per share | 14.2¢ | 16¢ |
| Net income for | | |
| the year | 347,000 | 470,000 |
| per share | 6.1¢ | 8.1¢ |
| Shareholders equity | 5,209,000 | 4,756,000 |
| Property, plant & equipment | 7,816,000 | 6,530,000 |
| Land holdings | | |
| gross acres | 1,939,000 | 2,958,000 |
| net acres | 1,226,000 | 2,090,000 |

ACREAGE HOLDINGS

January 31, 1978

| | Working Interest | | Royalty |
|---|------------------|------------------|------------------|
| | Gross acres | Net acres | Gross acres |
| CANADA | | | |
| Alberta | 146,600 | 56,300 | 136,300 |
| British Columbia | 1,400 | 700 | — |
| Saskatchewan | 10,900 | 10,900 | — |
| Arctic Islands | 929,300 | 649,000 | 695,100 |
| Beaufort Sea/Delta | — | — | 1,723,900 |
| Northwest Territories | — | — | 162,200 |
| Yukon Territory | — | — | 385,600 |
| Pacific Offshore | — | — | 243,400 |
| Atlantic Offshore | 550,600 | 412,900 | 163,700 |
| Ontario | 31,300 | 18,300 | — |
| INTERNATIONAL | | | |
| North Sea (U.K.) | 54,200 | 500 | — |
| Italy | 92,600 | 3,700 | — |
| Turkey | 122,900 | 73,800 | — |
| | <u>1,939,800</u> | <u>1,226,100</u> | <u>3,510,200</u> |
| Comparative holdings, January 31, 1977 | <u>2,958,400</u> | <u>2,090,300</u> | <u>3,510,200</u> |

Lochiel Exploration Ltd.

TO THE SHAREHOLDERS:

In 1977 Lochiel made further significant progress in its strategy of shifting emphasis from long-term development to current income-producing properties. Expenditures at a record level of \$1,286,000 were made for drilling and development, an increase of 87 percent over 1976. Approximately half of these funds was spent on developing proven reserves in Alberta and in the United Kingdom.

Operating results for fiscal 1977 were adversely affected by the 10 week shut-in, due to an Alberta gas surplus, of the company's largest gas producing property at Atlee Buffalo. Despite a resulting loss of revenue, total sales and cash flow declined only slightly in comparison with 1976 results. Production at Atlee Buffalo has since resumed at full capacity, but various proportioning schemes are being considered this year.

During the year Lochiel participated in drilling a record 18 wells. Of the nine completions resulting from this activity, six were in new horizons in the Atlee Buffalo area. The potential of these wells is being evaluated and they are expected to contribute to Lochiel's cash flow and earnings in 1978 and in future years.

Since the fall of 1977, management has taken a more aggressive approach to Crown land sales in Alberta and, as a result, the company acquired 1,600 net acres, including 906 acres (480 net acres) in the West Pembina region. These lands were purchased at a time of unprecedented competition for oil and gas properties in the province. Lochiel intends to explore for and develop petroleum reserves on these and other holdings by means of increased cash flow, joint ventures, and hopefully, drilling funds.

The Buchan oil field in the North Sea, in which Lochiel owns a one percent interest, offers excellent

prospects to the company. This field is presently in the development phase, with production expected to begin late in 1979. As reported to Lochiel's shareholders in a letter dated March 29, 1978, British Petroleum, which is the operator of the project, has recently completed a 20 hour production test on the first development well. This test covered a 110 metre (361 feet) interval and flowed at a rate in excess of 7,100 barrels of oil per day. Engineers estimate that this particular well is capable of producing 20,000 barrels per day. A second development well recently entered the top of the oil zone 574 metres (1,883 feet) above the water line indicating the thickest pay section so far encountered in the Buchan Field. Four additional development wells are being drilled. Due to the fractured nature of the reservoir, it is difficult to determine how much of the estimated 650 million barrels of oil in the structure is recoverable. Based on a relatively conservative 16 percent recovery factor, Lochiel's share would amount to one million barrels net.

The company's broad exposure in Canada's frontier areas will become increasingly important in the 1980's and beyond. In the Beaufort Sea Lochiel owns overriding royalties and carried working interests in some 1.7 million acres. Much of this acreage is within 15 to 25 miles from where Dome Petroleum has drilled four successful deep tests for oil and gas. At least three wells will be drilled in this area in 1978. Estimates on the size of the accumulations found are difficult to obtain but they are rumored to be comparable to the largest ever discovered in Canada.

In the rest of the Canadian Arctic, Lochiel continues to hold, at no cost, approximately 600,000 net working interest acres as well as 700,000 gross royalty acres. This area is recognized as having great hydrocarbon potential.

Lochiel's land inventory was reduced in 1977 by about one million gross acres due primarily to relinquishing permits in the Atlantic Offshore and Arctic Islands. It appears as though both federal and provincial governments are showing little urgency in developing these frontier areas at this time.

The company made two senior management appointments in 1977. Allen Emes, a chartered accountant who holds an M.B.A. in finance, was appointed treasurer, and J. Sheldon Crewson became vice president, exploration. Mr. Crewson, an Honours Graduate in geology from the University of Western Ontario, has had more than 25 years' experience in the oil and gas industry.

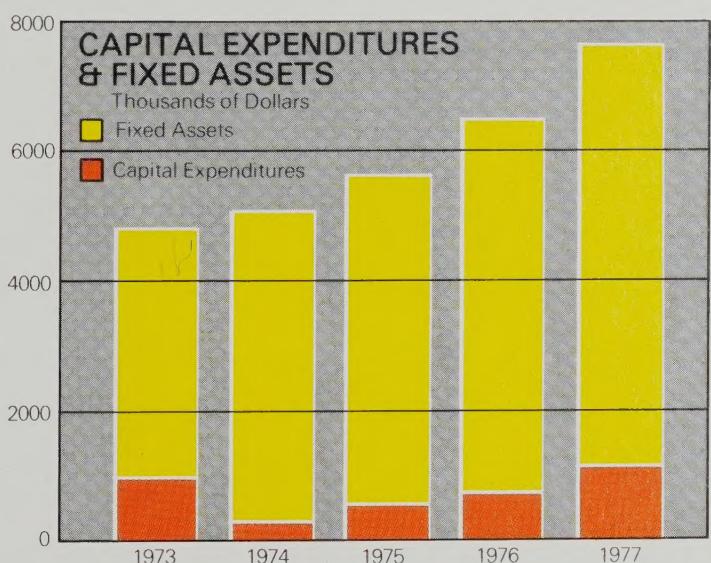
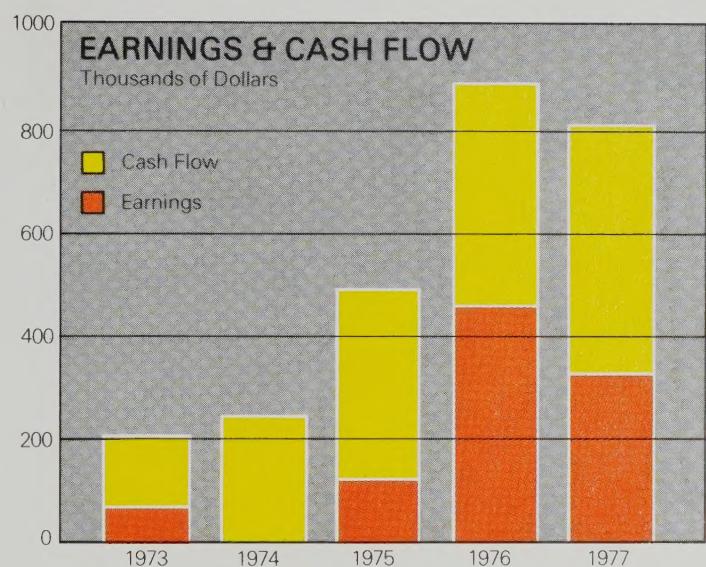
During the year J. C. Barron was elected to the board of directors. Mr. Barron, who is a senior partner in the Toronto investment firm of Cassels Blaikie & Co. Limited, will bring valuable financing and securities experience to Lochiel.

On behalf of the directors, I would like to thank all Lochiel employees for a job well done and for their contribution to the company's progress in 1977.

On behalf of the Board



Nicholas W. Taylor
President



N.W.T.

BUICK CREEK

BRITISH COLUMBIA

DIXONVILLE

EAGLESHAM

SWAN HILLS

WEST PEMBINA

PIGEON LAKE

QUIRK CREEK

CALGARY

ATLEE BUFFALO

CLARESHOLM

TABER

U.S.A.

ADAIR CREEK

FORT VERMILLION

LEGEND LAKE

MINK LAKE

ATHABASCA
OIL SANDS

BOHN
LAKE

EDMONTON

PROVOST

ALBERTA
LOCHIEL HOLDINGS

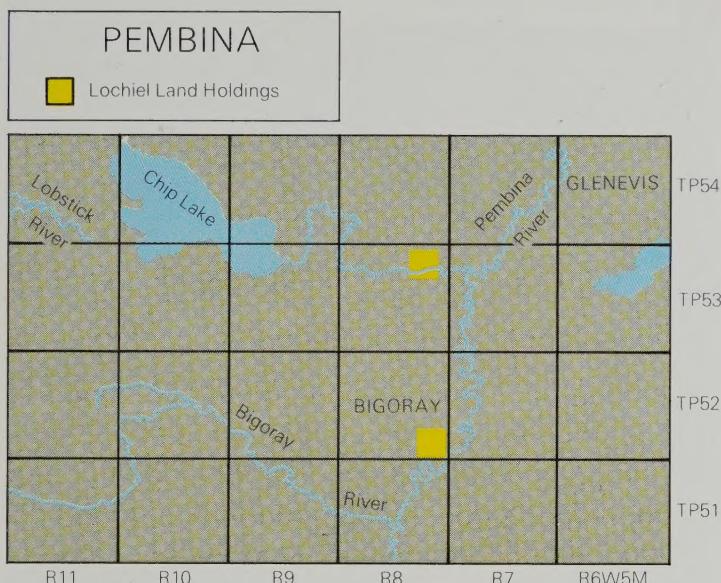
REVIEW OF OPERATIONS

Canadian Exploration and Development

ALBERTA

WEST PEMBINA

The company recently acquired a 50 percent interest in 960 acres in this area. Light oil has been discovered in the Devonian (Nisku) zone within two miles of the leases. The Nisku lies approximately 4,000 feet below the Cardium formation which has produced oil for almost 25 years.



QUIRK CREEK

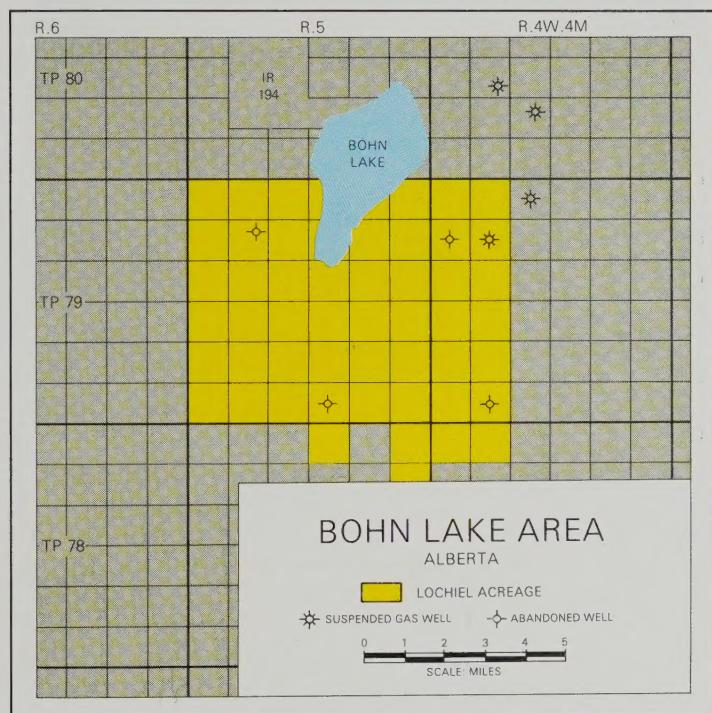
The company has a 0.75 percent net profit participation in the 50 percent interest owned by Husky et al, both in the Rundle formation and the Mount Head formation of the Quirk Creek gas field. Present production is about 52,000 MCF per day and the company is expected to be in a net profits position by the mid-1980's.

SWAN HILLS

Lochiel has a working interest in 2 units where oil is being produced at the rate of 2,700 barrels per day. The field, discovered in 1963, is expected to produce until at least 1998.

BOHN LAKE

In partnership with Canadian Homestead and Petromines, Lochiel made a recent gas discovery on this 28,800 acre block. By drilling the well, at no cost to Lochiel, Canadian Homestead as operator earned a 60 percent interest in the block with Petromines holding 13½ percent and Lochiel 26½ percent. Further evaluation drilling is planned next winter. The block is situated in an area where a gas pipeline is being considered.

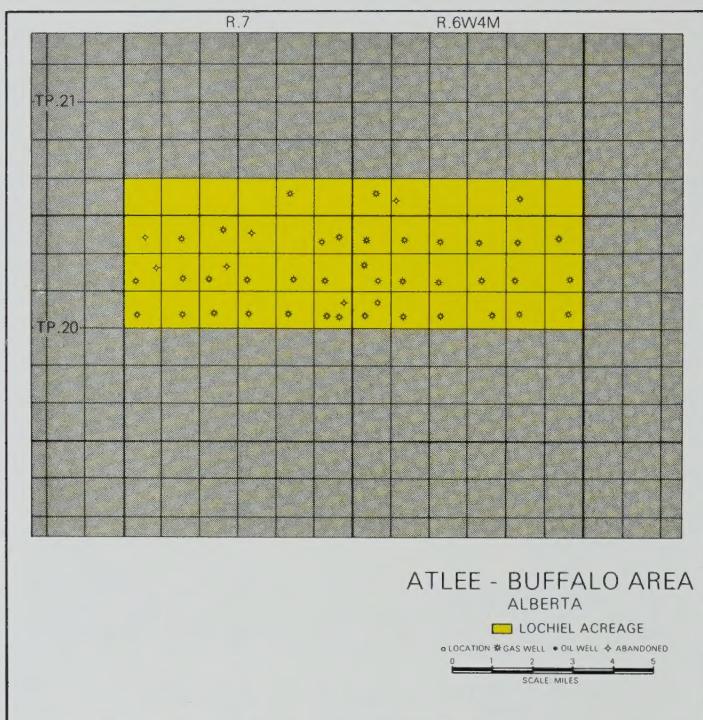


TABER

A discovery of medium gravity oil has recently been made less than one quarter mile from Lochiel's acreage. A well will shortly be drilled by Star Oil and Gas on Lochiel's 480 acre block at no cost to the company, with Lochiel retaining a 25 percent interest in the block. Lochiel participated in the acquisition of 960 acres of Crown land immediately offsetting the discovery. The company's interest in the new acquisition is 13½ percent.

ATLEE BUFFALO

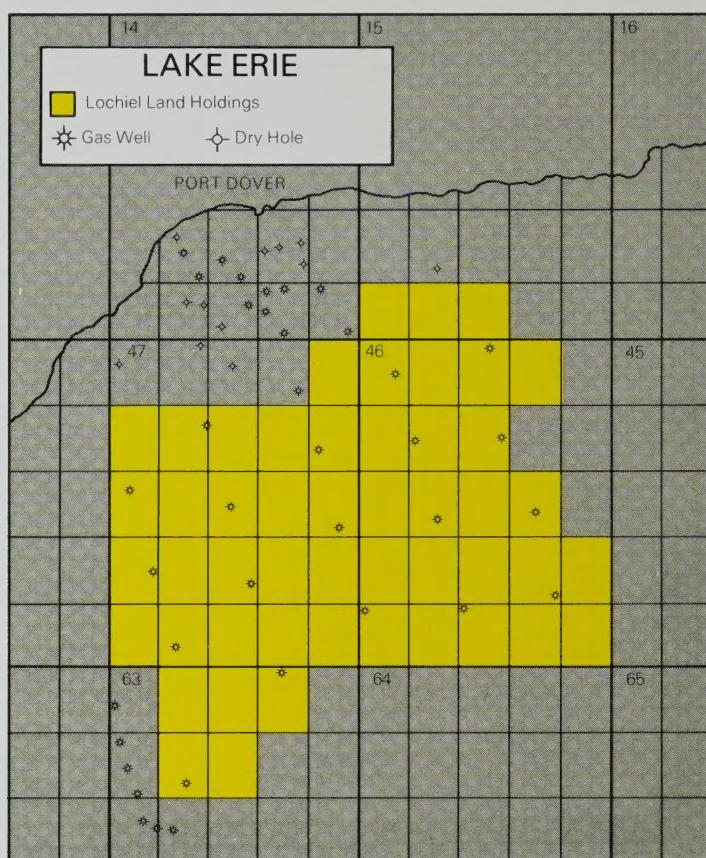
A 30,720 acre block (15,360 net acres) located in eastern Alberta is Lochiel's main producing property. A major step-out drilling program in 1977 resulted in six additional discoveries, some of which are expected to be producing by mid-1978. The field now produces 4,189 MCF per day. The company is examining the possibility of further development drilling in this region.



ONTARIO

LAKE ERIE

The company has a 58.67 percent working interest in natural gas leases and licences covering about 31,250 gross acres in the Lake Erie area of Ontario. At present 14 wells are producing gas from the Grimsby formation. Gas prices in Ontario are being allowed a modest increase and, as a result, further development drilling will be done in 1978 in this area.



BRITISH COLUMBIA

BUICK CREEK

Lochiel has granted a farmout to Czar Resources Ltd. on its Buick Creek acreage for the drilling of a Triassic test. Czar will earn the spacing unit subject to an overriding royalty until payout, at which time it will have earned a 50 percent interest in the entire acreage.

NORTHWEST TERRITORIES

BAKER LAKE – MINING PERMITS

Lochiel has an 8.6 percent participation in 288,000 acres at Baker Lake on the western shore of Hudson Bay, where uranium deposits were discovered in 1975 and 1976. Cominco has indicated that it will not continue its option to explore this prospect.

FRONTIER AREAS

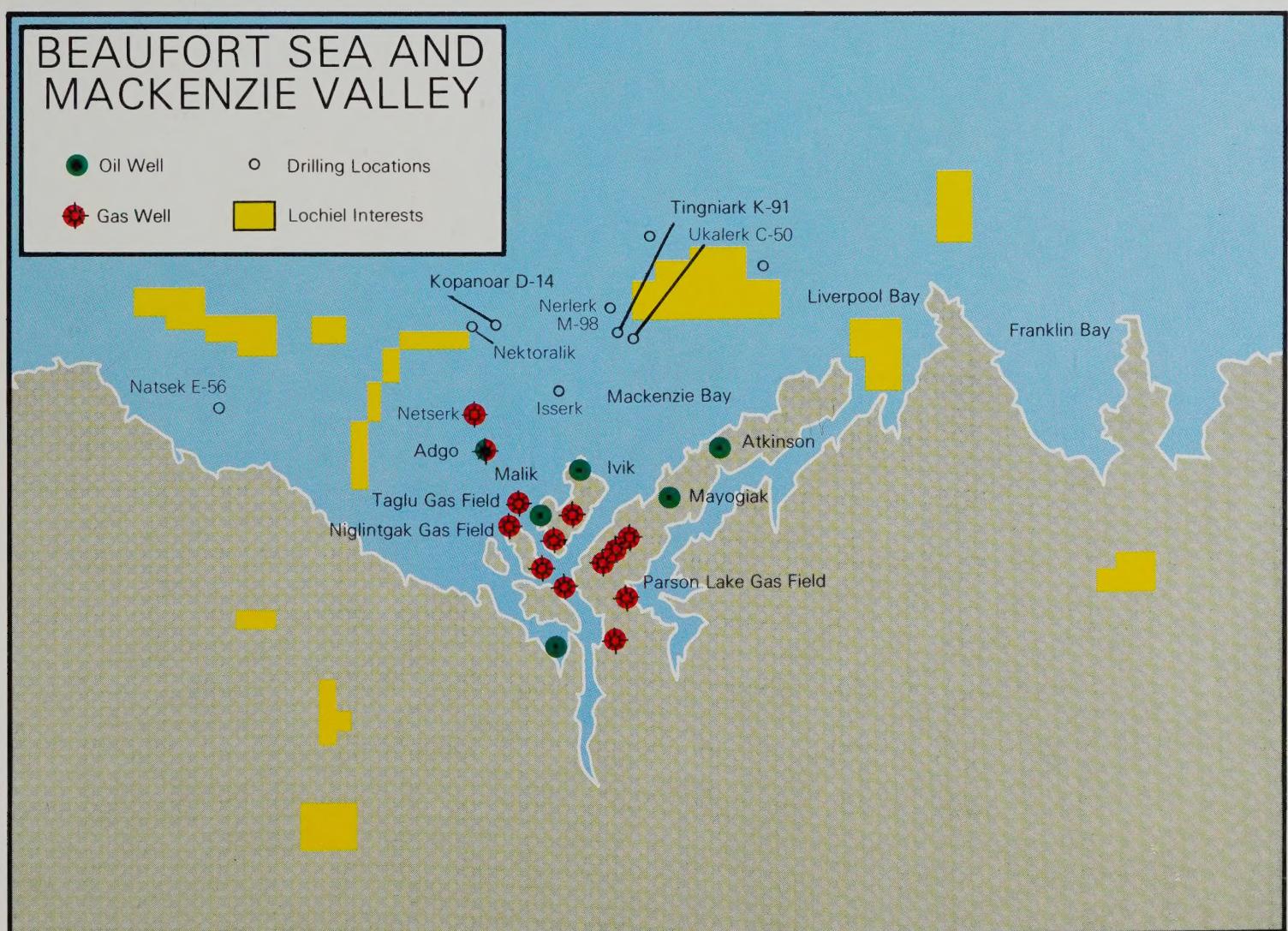
BEAUFORT SEA

Recent discoveries in the Beaufort Sea have given rise to further optimism about the hydrocarbon potential of the Beaufort Sea. Dome Petroleum announced significant discoveries of natural gas and oil in the general area of Lochiel's 1.7 million royalty acres in the Beaufort Sea. A well designated as Nektoralik K-59 flowed medium gravity oil to the surface at rates of up to 1,150 barrels per day.

Lochiel has a 1.40 percent net carried interest and .567 percent gross overriding royalty in 220,288 acres situated 10 miles south of Nektoralik; and a 3 percent gross overriding royalty in another 518,890 acres 50 to 100 miles east of the Nektoralik discovery.

Another well, the Ukalerk C-50, indicated an open flow of gas of more than 200 million cubic feet per day. Lochiel has a 0.567 percent gross overriding royalty and a 1.40 percent net carried interest on 386,937 acres located within 10 miles north of the Ukalerk well and a 0.3 percent gross overriding royalty on 213,298 acres located within 25 miles north of the well.

This year Dome Petroleum enters its third year of offshore drilling in the Beaufort Sea and has obtained government approval to extend the drilling season. This, combined with the attractive tax incentives now available to the financial partners, should result in increased activity in 1978 and 1979. Dome has the capability to re-enter four wells already partially drilled; all four indicated hydrocarbon discoveries. The company has also done preparatory work or set surface



casing at five other locations and now has a total of nine potential locations to work on in the current drilling season.

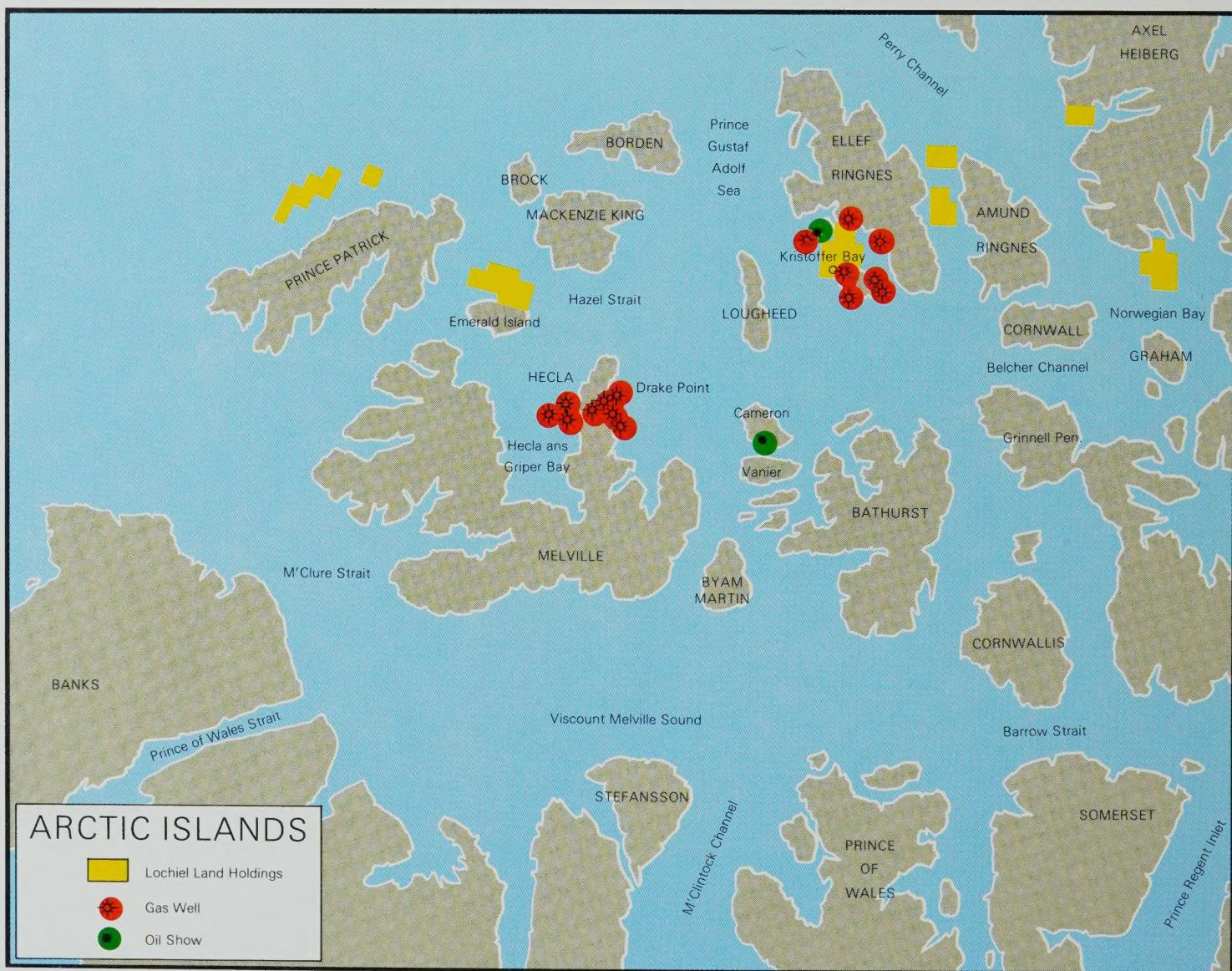
There is growing conviction that a marine transportation system may be a more economic method of moving hydrocarbons from the Beaufort region than a conventional pipeline. The advantages of marine transportation are:

1. A lower threshold of reserves is required to cost-justify marine transportation. A pipeline is estimated to take eight to ten times the reserves required for a system which uses ships.
2. Much of a marine transportation system could be

built in southern Canada and moved to the frontier. This would cut costs and boost employment in Canada.

3. A pipeline would require a substantially higher initial capital investment, estimated at about \$20 billion. By comparison, a dual tanker system for moving both oil and liquid natural gas (LNG) should cost approximately \$2 billion.

Lochiel's management believes that the Beaufort Sea resources will begin to alleviate Canada's hydrocarbon shortage far sooner than conventional thinking suggests, and that the area will become a major contributor to Lochiel's future earnings.



CANADIAN ARCTIC ISLANDS

On December 21, 1977 Polar Gas filed an application with the National Energy Board and the Department of Indian Affairs and Northern Development seeking approval for the construction and operation of a natural gas pipeline system from the Arctic Islands to markets in southern Canada. The proposed pipeline is to be 2,338 miles long and will connect with the TransCanada pipeline in southwestern Ontario. The cost of the project is estimated at \$6.1 billion.

Lochiel, with a working interest in 929,300 gross acres and in 695,100 gross royalty acres in the islands, is watching these developments with great interest. The Arctic Islands Exploration Group (Imperial Oil, Gulf Oil Canada, and Petro-Canada) has now accumulated more than 10,000 miles of seismic data. Over the next five years the Group plans to spend \$80 million with the object of proving up the commercial threshold level to

20 trillion cubic feet of gas. At present, it is estimated that there are more than 16 trillion cubic feet of proven gas reserves in the Arctic Islands.

Approximately five TCF of these proven reserves lie in the King Christian area in wells offsetting the 280,000 acres in which Lochiel has a right to a 12 percent working interest after the start of commercial production.

ATLANTIC OFFSHORE

Lochiel holds a total of 550,600 gross working interest acres (412,900 net acres) and 163,700 gross royalty acres on the Labrador Shelf of eastern Canada. Discoveries made in recent years indicate good hydrocarbon potential, although activity in this area has been limited, largely due to the inability of various governments to agree on jurisdictions.

Foreign Exploration and Development

THE UNITED KINGDOM

Appraisal drilling has been concluded in the Buchan field in the U.K. sector of the North Sea, where Lochiel has a one percent working interest. Consent was received from the Department of Energy to proceed with the development and production program submitted to it in June of 1977. British Petroleum will be operator on behalf of the group which consists of Candel, Transworld, St. Joe, G.O.A.L., Charterhall, B.N.O.C., Lochiel and B.P.

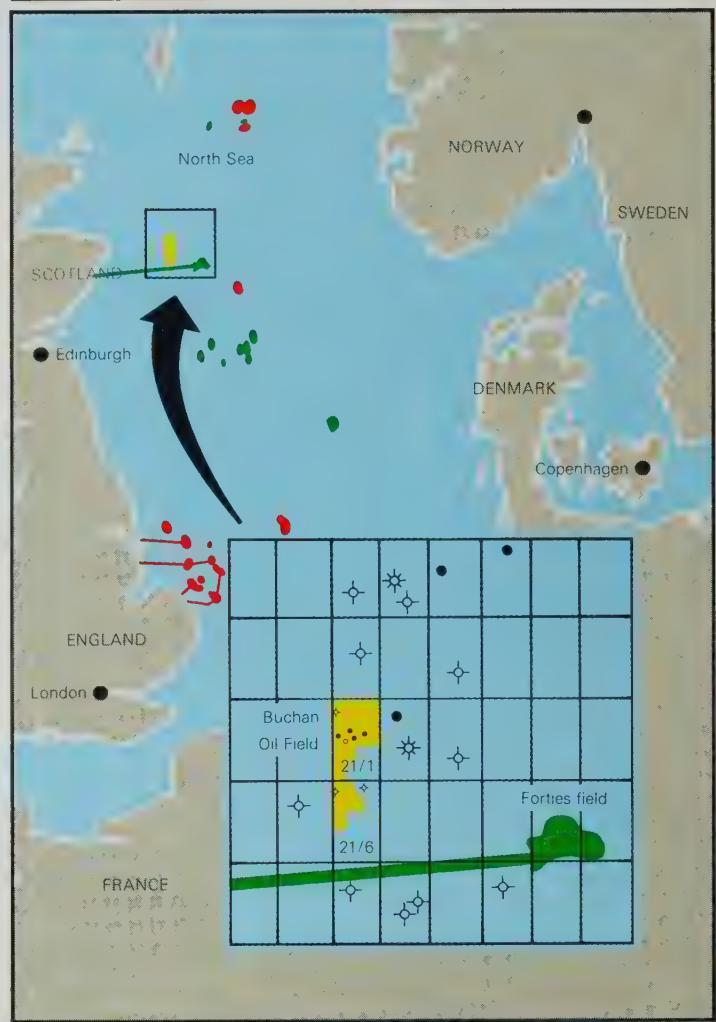
The development program approved by the Department of Energy calls for the drilling of seven wells and the re-entering of an appraisal well drilled in 1977. The extraction procedure will include a floating production system, similar to that used in the Argyll field. The wells will be drilled through a template and the oil will flow through a semi-submersible rig and be pumped into tankers via an offshore loading system. By using a floating production system it is thought that the first oil will be commercially available in late 1979—far sooner than if a fixed production platform were used.



Template through which Buchan development wells are to be drilled.

The development program in the Buchan Field permits a minimum annual average production rate of 50,000 barrels per day (500 net to Lochiel) and calls for the recovery of a minimum of some 50 million barrels of oil (500,000 to Lochiel) in the four years commencing late in 1979. The 50 million barrel figure is based on the lowest expected recovery factor. The geology of the Buchan field is extremely complex and unique to the North Sea. The fractured sandstone reservoir contains an oil column which is 574 metres (1,883 feet) thick in one appraisal well. It is estimated that the reservoir could contain as much as 650 million barrels, but because of its fractured nature it is not possible to accurately predict the recovery factor.

The company is optimistic about the future of the Buchan field. Even using the lowest expected recovery factor, the field is economic and, it is believed, the upside potential is extremely good. There are possibilities of further oil accumulations in the vicinity of the Buchan field which could also prove to be economic.



Ship preparing to transport Template to Buchan Field.

ITALY AND TURKEY

Lochiel is maintaining its interest in an oil and gas concession in Italy but intends to relinquish its holdings in Turkey. The company will continue to seek concessions in foreign countries where it is still possible to secure large, low cost land positions, offering good hydrocarbon potential.

5 YEAR HISTORICAL SUMMARY

| | 1977 | 1976* | 1975* | 1974* | 1973 |
|---|-------------|-------------|-------------|------------|------------|
| Oil & gas sales | \$1,796,000 | \$1,806,000 | \$1,041,000 | \$ 655,000 | \$ 537,000 |
| Royalties paid | 590,000 | 537,000 | 264,000 | 137,000 | 77,000 |
| Total net revenue | 1,211,000 | 1,334,000 | 779,000 | 532,000 | 481,000 |
| Operating costs | 260,000 | 201,000 | 172,000 | 143,000 | 112,000 |
| General & administration costs | 183,000 | 139,000 | 97,000 | 100,000 | 88,000 |
| Interest paid | 89,000 | 123,000 | 78,000 | 101,000 | 80,000 |
| Cash flow from operations | 812,000 | 930,000 | 504,000 | 247,000 | 202,000 |
| Cash flow per share | 14.2¢ | 16.0¢ | 8.6¢ | 4.4¢ | 3.6¢ |
| Depletion, depreciation & write-offs | 248,000 | 289,000 | 249,000 | 172,000 | 90,000 |
| Deferred income tax, net | 84,000 | 111,000 | 31,000 | 33,000 | 37,000 |
| Net income before extraordinary items | 347,000 | 470,000 | 152,000 | (16,000) | 75,000 |
| Extraordinary items | — | — | 258,000 | — | — |
| Net income | 347,000 | 470,000 | (105,000) | (16,000) | 75,000 |
| Per share | 6.1¢ | 8.1¢ | (1.8¢) | (0.3¢) | 1.3¢ |
| Capital expenditures | 1,286,000 | 697,000 | 612,000 | 341,000 | 1,016,000 |
| Working capital | 434,000 | 429,000 | 187,000 | 153,000 | 166,000 |
| Fixed assets | 7,816,000 | 6,530,000 | 5,833,000 | 5,274,000 | 5,077,000 |

*Restated

RECOVERABLE ESTIMATED RESERVES OF OIL, NATURAL GAS LIQUIDS, AND NATURAL GAS

| | <u>Proven</u> | <u>Probable</u> | <u>Total</u> |
|--|---------------|-----------------|--------------|
| Crude Oil—Canada (thousands of barrels) | 150.0 | 92.0 | 242.0 |
| Crude Oil—U.K. (thousands of barrels) | 500.0 | 500.0 | 1000.0 |
| Natural Gas Liquids—Canada (thousands of barrels) | 31.0 | 51.0 | 82.0 |
| Natural Gas—Canada (billions of cubic feet) | 19.0 | 2.0 | 21.0 |

FINANCIAL REVIEW

In 1977 the company maintained the level of gross revenue reached in 1976, although net income and cash flow declined to 6.1¢ and 14.2¢ per share respectively. This was due to increased royalties and operating costs and also to the unexpected 10-week shut-in of the Atlee Buffalo property by TransCanada Pipelines. Management is hopeful that both cash flow and net income in 1978 will at least maintain 1977 levels.

Lochiel has entered a period of expansion and capital expenditures are expected to continue to increase. In 1977 the company spent a record \$1,286,000 on exploration, development and land acquisition. Approximately half of these funds came from cash flow generated internally. The remainder was covered by Lochiel's line of bank credit which, at fiscal year end, stood at \$2.4 million. It is not anticipated that the full effect of these expenditures will be reflected in increased earnings and cash flow until late 1979 and possibly early 1980.

Management expects that capital expenditures in 1978 will show an increase over 1977 due to the company's program of development drilling in Canada and also due to Lochiel's continuing participation in the costs of bringing the North Sea Buchan field on stream.

AUDITORS' REPORT

The Shareholders,

Lochiel Exploration Ltd.

We have examined the consolidated balance sheet of Lochiel Exploration Ltd. as at January 31, 1978 and the consolidated statements of income, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances:

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at January 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta, April 11, 1978. Touche, Ross & Co.
Chartered Accountants

Lochiel Exploration Ltd.

CONSOLIDATED STATEMENT OF INCOME

for the year ended January 31, 1978

| | <u>1978</u> | <u>1977</u> |
|---|-------------------|-------------------|
| <i>Revenue</i> | | |
| Oil and gas sales | \$1,795,562 | \$1,805,535 |
| less royalties and mineral taxes | <u>589,998</u> | <u>536,830</u> |
| Net sales | <u>1,205,564</u> | 1,268,705 |
| Other income | 4,836 | 2,602 |
| Gain on sale of investments | <u>993</u> | 62,550 |
| | <u>1,211,393</u> | <u>1,333,857</u> |
| <i>Expenses</i> | | |
| Operating | 259,996 | 201,412 |
| General and administrative | 183,408 | 139,250 |
| Interest on long-term financing | 88,943 | 122,781 |
| Depletion and depreciation | <u>247,986</u> | 288,863 |
| | <u>780,333</u> | <u>752,306</u> |
| <i>Income before income taxes</i> | <u>431,060</u> | 581,551 |
| <i>Income taxes</i> | | |
| Current—Provincial royalty tax credit | (133,715) | (122,483) |
| Deferred | <u>218,140</u> | <u>233,953</u> |
| | <u>84,425</u> | <u>111,470</u> |
| <i>Net income for the year</i> | <u>\$ 346,635</u> | <u>\$ 470,081</u> |
| Net income per share (based on average number of shares outstanding during the year) | <u>6.1¢</u> | <u>8.1¢</u> |

CONSOLIDATED STATEMENT OF DEFICIT

for the year ended January 31, 1978

| | | |
|------------------------------------|-------------------|-------------------|
| Deficit at beginning of year | \$ 651,722 | \$1,121,803 |
| Net income for the year | <u>346,635</u> | <u>470,081</u> |
| Deficit at end of year | <u>\$ 305,087</u> | <u>\$ 651,722</u> |

Lochiel Exploration Ltd.

CONSOLIDATED BALANCE SHEET

as at January 31, 1978

ASSETS

| | <u>1978</u> | <u>1977</u> |
|---|--------------------------|--------------------------|
| <i>Current Assets</i> | | |
| Cash and term deposits | \$ 17,652 | \$ 105,450 |
| Accounts receivable—trade | 241,800 | 201,806 |
| Provincial royalty tax credit | 255,774 | 190,336 |
| Prepaid expenses | 6,636 | 5,934 |
| | <u>521,862</u> | <u>503,526</u> |
| <i>Investments and long-term receivables</i> (Note 2) | 540,154 | 522,642 |
| <i>Property, plant and equipment at cost</i> | | |
| Oil and gas properties | 6,750,629 | 5,495,109 |
| Production equipment | 1,052,820 | 1,026,341 |
| Other | 13,036 | 9,046 |
| | <u>7,816,485</u> | <u>6,530,496</u> |
| Less accumulated depletion and depreciation | <u>1,411,112</u> | <u>1,163,126</u> |
| | <u>6,405,373</u> | <u>5,367,370</u> |
| | <hr/> <u>\$7,467,389</u> | <hr/> <u>\$6,393,538</u> |

SIGNED ON BEHALF OF THE BOARD

N. W. TAYLOR, *Director*
W. A. WORK, *Director*

LIABILITIES

| | <u>1978</u> | <u>1977</u> |
|---|------------------|------------------|
| <i>Current Liabilities</i> | | |
| Accounts payable | \$ 87,942 | \$ 74,552 |
| <i>Prepaid production revenue</i> | — | 126,293 |
| <i>Long-term debt</i> (Note 3) | | |
| Production loans | 1,413,621 | 898,442 |
| <i>Deferred income taxes</i> | 756,753 | 538,613 |
| <i>Total liabilities</i> | <u>2,258,316</u> | <u>1,637,900</u> |

SHAREHOLDERS' EQUITY

Capital stock (Note 4)

Authorized
10,000,000 shares of no par value

| | | |
|---|---------------------------|---------------------------|
| Issued | | |
| 5,739,326 shares (1977 – 5,679,326) | 5,514,160 | 5,407,360 |
| Deficit | (305,087) | (651,722) |
| | <u>5,209,073</u> | <u>4,755,638</u> |
| | <u><u>\$7,467,389</u></u> | <u><u>\$6,393,538</u></u> |

Lochiel Exploration Ltd.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

for the year ended January 31, 1978

| | <u>1978</u> | <u>1977</u> |
|---|-------------|-------------|
| <i>Sources of funds</i> | | |
| From operations | | |
| Net income for the year | \$ 346,635 | \$ 470,081 |
| Add items not requiring current outlay of funds | | |
| Depletion and depreciation | 247,986 | 288,863 |
| Deferred income taxes | 218,140 | 233,953 |
| Gain on sale of investments | (993) | (62,550) |
| <i>Funds from operations</i> | 811,768 | 930,347 |
| Issue of shares | 106,800 | 18,500 |
| Increase in production loans | 909,424 | 513,898 |
| Decrease in investments and long-term receivables | 3,993 | 187,695 |
| | 1,831,985 | 1,650,440 |
| <i>Uses of funds</i> | | |
| Property, plant and equipment | 1,285,989 | 697,158 |
| Repayment of production loans | 394,245 | 395,142 |
| Increase in investments and long-term receivables .. | 20,512 | 32,836 |
| Reduction of prepaid production revenue | 126,293 | 73,707 |
| Cancellation of shares | — | 209,606 |
| | 1,827,039 | 1,408,449 |
| <i>Increase in working capital</i> | 4,946 | 241,991 |
| <i>Working capital at beginning of year</i> | 428,974 | 186,983 |
| <i>Working capital at end of year</i> | \$ 433,920 | \$ 428,974 |

Lochiel Exploration Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended January 31, 1978

1. Summary of Significant Accounting Policies

(a) PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Lochiel Exploration (U.K.) Limited, Lochiel Oil and Gas (1972) Ltd. and Lochiel Exploration Inc. (inactive).

(b) EXPLORATION AND DEVELOPMENT COSTS

The Company follows the full cost method of accounting. Under this concept, all costs relating to the exploration for and the development of oil and gas reserves, including related overhead costs, are capitalized. Proceeds from disposal of properties are normally deducted from costs without recognition of gain or loss.

(c) DEPLETION AND DEPRECIATION

Depletion of exploration and development costs and depreciation of production equipment related to Canadian operations, except frontier areas, are computed under the unit of production method based on estimated proven oil and gas reserves. Costs related to Canadian frontier areas and foreign areas are carried in separate cost centres on which amortization is deferred pending the outcome of exploration.

(d) DEFERRED INCOME TAXES

The Company follows the tax allocation method of recording income taxes for all timing differences between accounting income and taxable income.

2. Investments and Long-term Receivables

| | <u>1978</u> | <u>1977</u> |
|--|------------------|------------------|
| Investment and advances—Petromines Ltd. | \$231,822 | \$217,245 |
| Investment in shares of other companies | 712 | 712 |
| Notes receivable from employees, at cost | 286,270 | 280,335 |
| Refundable deposits, at cost | <u>21,350</u> | <u>24,350</u> |
| | <u>\$540,154</u> | <u>\$522,642</u> |

The Company holds 903,281 shares (approximately 24%) of the issued capital of Petromines Limited, of which 374,281 shares are subject to an escrow agreement. These shares have been recorded at cost less a valuation allowance of \$182,027.

Notes receivable from employees totalling \$286,270 remain outstanding as consideration for shares purchased under employee stock purchase and option plans. The notes are non-interest bearing and mature between 1980 and 1984.

3. Long-term Debt

The bank production loans are evidenced by demand promissory notes and are secured on assignment of book debts and by oil and gas properties. The loans are repayable out of future production proceeds and accordingly, are not expected to require the use of existing working capital.

4. Capital Stock

| | 1978 | | 1977 | |
|---|------------------|--------------------|------------------|--------------------|
| | Number of Shares | Share Capital | Number of Shares | Share Capital |
| Balance at beginning of year | 5,679,326 | \$5,407,360 | 5,828,126 | \$5,598,466 |
| Issued for cash under employee stock plans | 60,000 | 106,800 | 10,000 | 18,500 |
| Cancelled and returned to treasury | — | — | (158,800) | (209,606) |
| | <u>5,739,326</u> | <u>\$5,514,160</u> | <u>5,679,326</u> | <u>\$5,407,360</u> |

At January 31, 1978, 75,000 shares were reserved for issue to an employee as an incentive stock option. This option is exercisable in annual installments over a five year period ending in 1982 and for a price of \$2.15 per share.

Under the employee share purchase plan, 140,000 shares remain reserved for issue in the future.

5. Contingent Liabilities

- i) The Company has issued non-interest bearing promissory notes and guarantees totalling \$137,000 in favour of various governmental authorities as security for exploratory commitments.
- ii) Under a joint interest agreement covering the exploration and development of the Buchan Field in the U.K. sector of the North Sea, the Company is to contribute as its share of the project approximately 1,300,000 pounds sterling during the period 1978-81.
- iii) Under various contracts with a financial institution the Company has arranged to purchase 715,000 pounds sterling at various dates in 1978 and 1979 at a rate of 1 pound sterling = \$2.10.

6. Remuneration of Officers and Directors

The aggregate direct remuneration of directors and officers is as follows:

| | Number | Amount |
|---|--------|-----------|
| Directors | 6 | \$ 4,200 |
| Officers, of whom two were also directors | 4 | \$171,700 |

DIRECTORS

J CHRISTOPHER BARRON

President, Cassels, Blaikie & Co. Limited, Toronto, Ontario

MERVYN S DEVONSHIRE

Partner, Devonshire, Munro & Co., Chartered Accountants, Calgary, Alberta

WILLIAM J MAJOR, Q.C.

Partner, Major Caron & Company, Barristers & Solicitors, Calgary, Alberta

RALPH T SCURFIELD

President, Nu-West Development Corporation Ltd., Calgary, Alberta

NICHOLAS W TAYLOR

President of the Company, Calgary, Alberta

WILLIAM A WORK

Vice President of the Company, Calgary, Alberta

OFFICERS

NICHOLAS W TAYLOR, President

WILLIAM A WORK, Vice President

J SHELDON CREWSON, Vice President - Exploration

ALLEN F EMES, Treasurer & Corporate Secretary

CORPORATE INFORMATION

HEAD OFFICE

550 6th Ave. S.W., Calgary, Alberta T2P 0S2

REGISTRARS AND TRANSFER AGENTS

GUARANTY TRUST COMPANY OF CANADA
311 8th Ave. S.W., Calgary, Alberta and
366 Bay Street, Toronto, Ontario

BANKING

THE TORONTO-DOMINION BANK, Calgary Place, Calgary, Alberta

AUDITORS

TOUCHE ROSS & CO
3500 Scotia Centre
Calgary, Alberta

SOLICITORS

MAJOR CARON & COMPANY
1801, 715 6th Ave. S.W., Calgary, Alberta

SHARES LISTED (Symbol LHX)

TORONTO STOCK EXCHANGE
ALBERTA STOCK EXCHANGE

1977
Annual
Report
Lochiel Exploration Ltd.

Lithographed in Canada

AR23

Please notify us if
your address has changed.

Lochiel Exploration Ltd.
890 Calgary House
550 - 6th Avenue S.W.
CALGARY, ALBERTA T2P 0S2

INTERIM REPORT

SECOND QUARTER
1977

File

*Lochiel
Exploration
Ltd.*

TO THE SHAREHOLDERS:

During the second quarter of the current fiscal year, your company continued on its upward trend in growth and, so far this year, participated in 13 exploratory oil and gas wells — more than in any similar period in Lochiel's history. This number may well grow to 20 wells by year-end.

Of the 13 wells drilled to date, 6 were abandoned, 5 will be new discoveries (some in more than one zone) and the jury is still out on 2 others.

As to the financial aspects of Lochiel's progress, sales of oil and gas for the first six months were up slightly to \$960,000 from \$956,000. However, higher royalties and expenses reduced cash flow from operations to \$421,000 or 7.4 cents per share, from \$454,000 and 7.8 cents per share. Net income for the period was \$219,000 or 3.9 cents per share compared to \$325,000 or 5.6 cents per share.

Working capital amounted to \$405,000 compared to \$429,000 at 1976 fiscal year-end, however your company's bank line of credit was increased to cover any possible further cash needs in the near future.

It may be of interest to shareholders that for the first time your company is participating in a wildcat in the United States. Lochiel has a 19 percent interest in a well now being drilled in California, 10 miles southeast of South Cuyama oilfield, and approximately 100 miles south of Santa Barbara.

Lochiel and Pan Canadian Petroleum Limited each with a 50 percent interest, are continuing an aggressive wildcatting program in the Atlee area of southern Alberta, where they jointly hold approximately 31,000 acres of leases. To these holdings some 3,520 acres in licences have been added over the last two months through acquisitions at Crown sales. No full details of the Atlee drilling program can be given at this time because of contemplated further land sales in the area. Of the seven tests drilled so far, two have been abandoned, but the other five show indications

that they will become gas or heavy oil producers from a number of different horizons which have not been developed on Lochiel's leases before.

In the North Sea BP has taken over as operator on permits 21-1 and 21-6. Drilling on Block 21-6 is approaching the main prospective horizon in one wildcat and another rig is being moved in to start a second wildcat. Meanwhile, work is in progress preparing onshore production facilities for the Buchan field. A rig has been contracted and is in the process of moving into this field to start drilling development wells, with the first two expected to be completed by the end of this year.

Lochiel owns royalty and carries interest in approximately 1.7 million acres in the Beaufort Sea. Dome Petroleum Ltd., which is currently engaged in a three-well drilling program in the general area of Lochiel's interests, announced recently that natural gas was encountered at all three locations.

As to your company's mining interests, little work was done this year by Cominco Ltd., on the Baker Lake uranium farmout covering approximately 288,000 acres, in which your company has an 8.6 percent interest. Cominco has the option to continue with the exploration program for the next year.

Your company participated in a prospecting crew which worked in the same area during the summer on a project unrelated to the Cominco farmout. In addition, Lochiel took part in a prospecting venture in the Yukon.

Outside Canada, Lochiel, along with other Canadian companies, has bid unsuccessfully for oil and gas concessions in Spain and Australia. Your management continues to spend some time evaluating foreign prospects where there are chances of large reserves.

On behalf of the Board,
Nicholas W. Taylor,
President

September 28th, 1977

Lochiel Exploration Ltd.

**Consolidated Statement of Changes
in Financial Position**

FOR SIX MONTHS ENDED JULY 31, 1977
(unaudited)

| | <u>1977</u> | <u>1976</u> |
|---|-------------------------|-------------------------|
| SOURCES OF FUNDS | | |
| From operations | | |
| Net income for the period | \$219,000 | \$325,000 |
| Add items not requiring current outlay of funds: | | |
| Depletion and depreciation | 146,000 | 109,000 |
| Deferred income taxes | 56,000 | 20,000 |
| CASH FLOW FROM OPERATIONS | | |
| Issue of shares | — | 18,000 |
| Increase in production loans | 140,000 | 85,000 |
| Decrease in investments and long-term receivables | 72,000 | — |
| | <u>633,000</u> | <u>557,000</u> |
| USES OF FUNDS | | |
| Property, plant and equipment | 358,000 | 223,000 |
| Repayment of production loans | 222,000 | 154,000 |
| Increase in investments and long-term receivables | — | 18,000 |
| Reduction in prepaid production revenue | 77,000 | 24,000 |
| | <u>657,000</u> | <u>419,000</u> |
| DECREASE (INCREASE) IN WORKING CAPITAL | | |
| at beginning of period | <u>24,000</u> | <u>(138,000)</u> |
| WORKING CAPITAL | | |
| at end of period | <u><u>\$405,000</u></u> | <u><u>\$325,000</u></u> |

Lochiel Exploration Ltd.

Consolidated Statement of Income

FOR SIX MONTHS ENDED JULY 31, 1977
(unaudited)

| | <u>1977</u> | <u>1976</u> |
|---|-------------------------|-------------------------|
| REVENUE | | |
| Oil and gas sales | \$960,000 | \$956,000 |
| Less: royalties and mineral taxes | 309,000 | 289,000 |
| Net sales | 651,000 | 667,000 |
| Other income | 2,000 | 1,000 |
| | <u>653,000</u> | <u>668,000</u> |
| EXPENSES | | |
| Operating | 93,000 | 89,000 |
| General and administrative | 94,000 | 58,000 |
| Interest — long term financing | 45,000 | 67,000 |
| | <u>232,000</u> | <u>214,000</u> |
| CASH FLOW FROM OPERATIONS | <u>421,000</u> | <u>454,000</u> |
| NON-CASH CHARGES | | |
| Depletion and depreciation | 146,000 | 109,000 |
| Deferred income taxes | 56,000 | 20,000 |
| | <u>202,000</u> | <u>129,000</u> |
| NET INCOME FOR THE PERIOD | <u><u>\$219,000</u></u> | <u><u>\$325,000</u></u> |
| RESULTS PER SHARE: | | |
| Cash flow from operations | 7.4¢ | 7.8¢ |
| Net income for the period | 3.9¢ | 5.6¢ |

Lochiel Exploration Ltd.

Consolidated Balance Sheet

AS AT JULY 31, 1977

(unaudited)

| | <u>1977</u> | <u>1976</u> |
|--|--------------------|--------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | \$ 83,139 | \$ 50,276 |
| Accounts receivable — trade | 230,176 | 215,004 |
| Provincial royalty tax rebate | 122,059 | 67,853 |
| Prepaid expenses | 6,250 | 4,540 |
| | <u>441,624</u> | <u>337,673</u> |
| INVESTMENTS AND LONG-TERM RECEIVABLES | 450,337 | 633,457 |
| PROPERTY, PLANT AND EQUIPMENT AT COST | 6,888,450 | 6,056,413 |
| Accumulated depletion and depreciation | <u>(1,309,126)</u> | <u>(983,263)</u> |
| | <u>5,579,324</u> | <u>5,073,150</u> |
| | <u>\$6,471,285</u> | <u>\$6,044,280</u> |
| LIABILITIES | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 36,415 | \$ 12,597 |
| PREPAID PRODUCTION REVENUE | 48,742 | 175,881 |
| LONG-TERM DEBT | | |
| Production loans | 816,442 | 710,836 |
| DEFERRED INCOME TAXES | <u>594,613</u> | <u>324,660</u> |
| Total Liabilities | <u>1,496,212</u> | <u>1,223,974</u> |
| SHAREHOLDERS' EQUITY | | |
| CAPITAL STOCK | | |
| Authorized | | |
| 10,000,000 shares of no par value Issued | | |
| 5,679,326 shares (5,836,126 in 1976) | 5,407,360 | 5,616,966 |
| DEFICIT | <u>(432,287)</u> | <u>(796,660)</u> |
| | <u>4,975,073</u> | <u>4,820,306</u> |
| | <u>\$6,471,285</u> | <u>\$6,044,280</u> |